Budget Tidbits… just the facts

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Reform before Revenue: A Roadmap to Better State Government

In crisis, there is opportunity. While the Legislature will undoubtedly be faced with many unpleasant and difficult choices, it must also seize the moment to make necessary reforms to state government that will improve its effectiveness, cost-efficiency, and sustainability, both in the short- and long-term.

I. Budget Principles

While "reform before revenue" may be catchy, it is also apt. In building a budget, I believe the following approach should be taken:

1. "Prioritize" – Fund highest-priority items first. The first step is to build a budget within the revenue "box." While there may be differences of opinion about what constitutes the highest priority, there should be no disagreement it is the Legislature's moral duty to see that available revenues are used to fund highest-priority items first.

2. "Reform" – Next, a critical examination should be undertaken to ensure a better, smarter, and more effective state government that squeezes every last ounce of value out of taxpayer dollars. Reforms can yield short- or long-term benefits. They can generate savings or better outcomes. They can mean getting the state entirely out of an activity or altering how things are done. The unifying characteristic is these are changes that should be pursued even absent a fiscal crisis because they are the right thing to do. And, yes, reforms can and should look at both expenditures and tax policy.

3. "Revenue" – Only after exhausting reforms and ensuring existing funds are dedicated to the highest-priority items should the Legislature entertain revenue options it does not believe are good policy in and of themselves.

Finally, underlying all of these decisions should be the notion of sustainability: permanent changes are preferable to temporary fixes.

II. Reform Ideas

What can be done to reform state government? Plenty.

Here are but a few ideas, each designed to improve outcomes, yield cost savings, or address budget sustainability.

1. K-12 reforms
- ***--Student success: Implement policies to promote and support teaching excellence***
- ***--Compensation: Migrate from paying teachers based on graduate credits to paying based on competency***
- ***-- Paramount duty: Ensure state's funding is ample, equitable, and dependable***
- ***--Opportunity gap: Provide tools and flexibility to chronically low-performing schools to quickly begin improving student achievement success measures.***
- ***--Health care expenses: Reduce costs by consolidating K-12 health benefits purchasing***

2. B&O tax reform: Change preferential rates, provide exemption for new businesses
3. Collective-bargaining reform: Give governor and Legislature tools in crisis
4. Competitive contracting: Fulfill a promise made in 2002
5. State lawsuit-abuse reform: Bring costs under control
6. Debt service: Constitutional amendment
7. Pensions: Put new employees in defined-contribution plan to improve long-run budget stability
8. Natural resources: Streamline water rights and environmental permitting and other reforms
9. Medicaid: Cost-sharing and more frequent eligibility verification
10. In-home care: Convert to stipend model for providers caring for family members
11. Examine non-citizen social-service funding
12. Ease state's future financial liability by eliminating unfunded laws

A. **K-12**

- **Student success: Implement policies to promote and support teaching excellence –** The single biggest in-school factor affecting student success is the quality of instruction. Establishing policies that support effective classroom practice and instructional delivery, based on objective evaluations of competency, will give every student the opportunity to achieve academic success and earn a family wage-job.

There are several policy reforms that build a system of performance management that would better support excellence in public education, including:

- Completing the piloting and implementation of, and train principals and teachers on a common statewide, four-tier teacher evaluation system.
- Creating a Principal Mentor Program to ensure fidelity in the four-tier evaluation system's implementation.
- Enabling school and district leaders to retain, transfer and place teachers based on evaluated competency and skills match instead of "years of service";
- Requiring educator continuing contracts to be earned based on performance; and
- Implementing an expedited and fair educator dismissal process for those teachers and principals rated ineffective if they have not improved after receiving targeted, individualized, intensive professional development, coaching and support.

- **Compensation: Migrate from paying teachers based on graduate credits to paying based on competency** – State government drives out salaries to districts based on a teacher's longevity and educational attainment. Research shows this model is a poor use of taxpayer dollars, especially paying teachers based on graduate credits which researchers have found bear "no relation to student achievement."[1]

  Washington, particularly, is a candidate for reform in this area. According to the University of Washington's Center on Reinventing Public Education, this state has a higher percentage of total education expenditures going to master's degree salary "bumps" than any other state in the country (3.3%, or more than $330 million a year).[2]

  As the report pointedly says,

  > *"During this time of fiscal stringency, it should raise eyebrows when a state automatically allocates over 3 percent of the average per-pupil expenditure in a manner that is not even suspected of promoting higher levels of student achievement."*[3]

  Agreed. In the long run, the state cannot afford to devote $330 million a year toward a policy that yields no benefit to student achievement; these funds need to be redirected over time to rewarding great teachers.

Finally, a note on why "Reform before Revenue" is so vital:

> The governor proposes cutting the school year and asking every citizen in the state to pay more to retain $251 million in core K-12 funding, while leaving in place this $330 million-a-year expenditure that research shows is of minimal value to student achievement.
>
> Citizens would be right to question this approach. If they are to be asked to raise taxes, it's reasonable to think they will first expect assurance from policymakers that existing dollars are being spent in the most effective way possible.

- **<u>Paramount Duty: Ensure state's funding is ample, equitable, and dependable</u>** – Local levies are paying for an increasing share of school budgets. This leads to inequities between property-wealthy and -poor districts, and is at the heart of a lawsuit before the state Supreme Court alleging the state is failing to meet its paramount duty under its constitution (*"…make ample provision for the education of all children residing within its borders…").*

  A solution – one I offered in 2010 via Senate Bill 6858 – is to shift from local to state funding by increasing the state property tax and decreasing local levy authority an equivalent amount.[4] The benefits of this proposal would be significant:

  - *<u>More ample state funding</u>* – State funding would increase by more than $900 million a year;
  - *<u>More dependable funding</u>* – Funds would be dedicated to constitutionally-protected basic education and would not be temporary in nature, like local levies are;
  - *<u>More equitable funding</u>* – Basic services would be financed through a uniform levy rate across the state, rather than from local levies where property-poor areas have to pay a significantly higher levy rate than high-value property areas to receive the same level of service; and
  - *<u>Addresses core issues raised in lawsuit over state's K-12 financing</u>* – This solution would likely render moot a potential multibillion-dollar suit pending in the courts.

  The concept has bipartisan support, as the House Ways and Means Committee chairman, Rep. Ross Hunter, D- Medina, has put out his own proposal for a levy swap.[5] Addressing this issue would be a huge reform and should be at the forefront of the Legislature's agenda.

- **<u>Opportunity gap: Provide tools and flexibility to chronically low-performing schools to quickly begin improving student achievement success</u>** – In Washington, students from low-income families and students of color have fewer academic and economic opportunities than the population as a whole, and it is getting worse. Washington is one of nine states with a growing opportunity gap between students of color and white students, and between students from low-income families and those living in resource-rich households.

- Many of these schools have been underperforming for more than a decade. We have lost a generation of students while we keep doing the same things yet hoping for a different outcome. A student’s ZIP code should not dictate his or her academic and career opportunities. No student should be forced to stay in a chronically under-performing school. Washington should intervene in the chronically underperforming schools to give their students additional opportunities, through a proven, outcome-based alternative: establishing “Educational Innovation Zones.”

- Based on successful models in other districts and states, these Educational Innovation Zones would oversee the supervision, development, and encouragement of rebuilding these schools, through steps that include:
  - Contracting out the management of chronically low-performing schools to proven learning-management organizations;
  - Requiring use of performance contracts and revocation of contracts if building managers fail to meet them;
  - Using federal funding to implement innovative reforms such as longer school years, longer school days and technology-based learning;
  - Attracting teachers who best fit the learning environment by providing them with increased support, autonomy and pay; and
  - Attracting high-performing principals who can best manage an innovative learning environment through increased pay, autonomy and flexibility to meet the student achievement success measures.

- **Health care expenses: Reduce costs by consolidating K-12 health benefits purchasing** – A 2010 state auditor’s report found the state, local school districts, and teachers with families could all see savings by consolidating health benefits purchasing at the state level, as is done for state employees.[6]

B. Tax Reform

- **Business and occupation tax reform: Pare preferential rates, institute exemption for new businesses** – The state imposes B&O tax at three core rates: 1.5% for services, 0.484% for manufacturing, and 0.471% for retailing. However, over the years a variety of industries have been granted preferential rates.

  Tax policy would be improved in this state if these preferential rates were reviewed and, consistent with that policy review, pared back (still giving these industries a rate lower than most other businesses in the state), while using a portion of the revenues generated to address a long-standing flaw in the B&O tax: namely, that it is a competitive disadvantage for new businesses.

Businesses in their infancy are often not yet profitable, yet such businesses must pay tax in Washington, while they do not in most other states. Additionally, new businesses have a higher relative tax burden than established counterparts in Washington: According to the 2002 Gates Commission report, new businesses have a 48% higher tax burden than an established firm in the same industry.[7] This competitive disadvantage is reflected in the fact that Washington has the second-highest business failure rate in the country.[8]

This could and should be remedied by granting all new businesses a one-year B&O tax exemption and small businesses (less than 25 employees) a two-year exemption, with a 50% exemption in the third year. The state Department of Revenue estimates this would benefit 90,000 businesses over four years.[9]

Additionally, it would add a tool to Washington's economic toolbox, as out-of-state businesses choosing to locate in Washington would qualify for this exemption as a "new business" in our state.
This proposal would improve tax policy in the state, address a long-standing competitiveness flaw, add a tool to attract businesses to our state, generate immediate revenue for the state budget and allow more than 90,000 businesses to help grow the economy.

C. General Government

- **Collective-bargaining reform: Giving elected officials necessary flexibility in time of crisis** – State law provides that if a "significant revenue shortfall"' occurs after a collective bargaining agreement is approved, then both parties to the agreement shall enter into negotiation for a mutually agreed-upon modification of the agreement.[10]

  Twice in recent years the governor has invoked this provision to bring state employee unions back to the table. And twice the unions have refused to modify the agreement. The governor, at the recent release of her proposed 2011-13 supplemental budget, lamented that she couldn't force them to renegotiate.

  This is simply unacceptable. At a time when every other item in the state budget – including nursing homes, school days, and services for the developmentally disabled – are targeted for cuts, the Legislature's hands are effectively tied concerning collective-bargaining agreements. *(Note: The agreements in place now carry a $400 million "bow-wave" into next biennium, as the 3% salary reduction is temporary – salaries are restored to 100% at end of the biennia – and the state's employee funding rate is substantially lower than future biennia rates as it is financed with one-time Public Employee Benefits Board reserves.)*[11]

  State collective-bargaining law needs to be amended to give policymakers the necessary tools to prioritize all funding in times of economic crisis. This can be accomplished by providing that upon a declaration of a significant revenue shortfall, the economic provisions of the CBA are null and void.

Employees would retain all non-economic protections, but items that cost the state money would be available to be changed by the governor or Legislature.

- **Competitive contracting: Fulfilling a promise made in 2002** – In 2002, the same legislation that granted state employees the right to collectively bargain over wages and benefits made an equally important change giving the state the right to solicit competitive bids on services historically performed by state employees. The latter provision was to ensure services are provided at the best value to taxpayers.

  Yet, multiple studies have shown the competitive-contracting portion has not been utilized.[12] Partly this is due to the flawed structure of current law, under which an agency must initiate such a bid. Yet agency heads who work daily with their employees have little incentive to solicit bids, as doing so threatens to antagonize employees. Current law puts agency heads in an unenviable and often untenable position.

  A solution is Senate Bill 5316 (2011). It would spare agency heads the responsibility of determining when to solicit bids and create a Washington Competition Council that would be charged with, among other things, determining the privatization potential of a program or activity and performing a cost-benefit analysis. The 15-member council would comprise four agency representatives, four legislators, and seven members from the private sector.

  Here is the key reform my legislation offers: if the new competition council determines that outsourcing an activity may result in reduced costs and the activity being completed in a more cost-efficient and effective manner, the governor must direct the agency to pursue a contract using the competitive-contracting process.

  This, frankly, takes the politics out of the issue. The question of whether a service can be performed more efficiently and cost-effectively is a factual one, not a political one, and should be answered by an independent entity without a stake in the outcome. That is what SB 5316 would require.

- **State lawsuit-abuse reform: Bringing down costs** – Washington is one of the few states in the nation with almost no immunity or liability limits for tort claims asserted against it. In the 2011-13 budget state agencies will pay more than $150 million in premiums for tort claims and defense costs alone.[13] This is up 500% from 20 years ago.[14]

  A common-sense reform, employed in Florida, could save the state substantial amounts while still holding state agencies accountable: (a) judgments of more than $1 million against the state would have to be approved by the Legislature, in the form of a bill, and (b) the state would be liable only for its share of the fault. This would protect the state and taxpayers from being the “deep pocket”. Plus, on large judgments, it would allow elected officials to prioritize these taxpayer dollars against other vital needs, while simultaneously raising the Legislature’s attention to acts in which the state was found to have committed a tort.

In 2003, when this idea was proposed and adopted by the state Senate (but died in the House), the biennial savings were projected at $40 million.[15]

- **<u>Debt service: Constitutional amendment</u>** – Washington is a high-debt state: our state government debt *per capita* is more than twice the national median.[16]

  In this budget cycle alone, almost $2 billion of a roughly $30 billion operating budget will go to paying debt service. This is two times the amount of the state budget that goes to our four-year public colleges and universities. "Debt creep" is consuming an ever larger share of the budget and crowding out other priorities.
  A constitutional amendment to lower permissible debt would, over time, free up hundreds of millions of dollars each biennium for greater priorities. Such an amendment passed the Senate last year with overwhelming bipartisan support, but failed to receive a vote in the House.[17]

- **<u>Pensions: Put new employees in defined contribution plan to improve long-run budget stability</u>** – Ideally, pensions should be a consistent portion of the state budget, not subject to skipped payments or wild funding fluctuations. One way to accomplish that aim is to in the long run put new employees into a defined-contribution plan. Such a plan already exists for higher-education professors and professional staff, with an extremely high satisfaction rate; that model could be extended to all new state employees.

D. <u>Natural Resources</u>

- **<u>Streamline water rights and environmental permitting and other reforms</u>** – These include:
  (a) Changing the Department of Ecology's water-resource governance, so as to improve efficiency in water-rights permitting (House Bill 2121 [2011] or Senate Bill 6581 [2010]);
  (b) Identifying underutilized Department of Fish and Wildlife-controlled land for potential sale (Senate Bill 5376 – 2011);
  (c) Eliminating Ecology's greenhouse-gas reporting program by aligning requirements with federal reporting requirements; and
  (d) Consolidating natural-resource field offices and undertaking a close review of the activities of the state energy office and Puget Sound Partnership.

E. <u>Social Services</u>

- **<u>Medicaid: Cost-sharing and more frequent eligibility verification</u>** – Rather than reduce or eliminate core services, the state should impose co-pays and premiums and return to a six-month eligibility verification. These are common-sense approaches employed by many other states.

Unfortunately, federal healthcare reform requires states to maintain all 'eligibility standards, methods, and procedures' in place at the time the Patient Protection and Affordable Care Act (aka "Obamacare") became law.[18] This may preclude Washington from pursuing these options, since this state had 12-month verification and did not impose premiums at the time the federal law was adopted.

If so, Washington should push the White House hard for a waiver, utilizing the provisions of last session's Senate Bill 5596, or, failing success on that front, send Congress a resolution in support of Washington Congresswoman Cathy McMorris-Rodgers' H.R. 1683 ('The State Flexibility Act of 2011'), which would waive the maintenance-of-effort provision and give states the necessary flexibility to manage their Medicaid programs. The bipartisan National Governors Association calls Medicaid maintenance-of-effort reform one of the top priorities before Congress.[19]

- **In-home care: Convert to stipend model for providers caring for family members** – More than two-thirds of in-home care workers provide care solely for a family member. These workers receive a salary, health benefits, vacation, mileage reimbursement, state-paid workers' compensation, and through union negotiations have requested a state-funded retirement benefit. The state budget allocates more than $400 million a biennium to paying these individuals – which matches the total amount of state support to the University of Washington.[20]

  But is it the proper role of government to pay someone – as a "job" replete with vacation, mileage and possibly a retirement benefit – to care for a family member? These family members do provide a benefit to the state, for the care they provide is less costly than if the recipients were moved from their homes into facilities. As a society we should acknowledge that benefit and support these families in a positive way, but should the care being provided be treated as an occupation? Would it be more appropriate to instead provide a stipend to assist these families?

- **Examine non-citizen social-service funding** – The state spends in the neighborhood of $200 million each biennium on social-service programs benefitting non-citizens.[21] These include the non-citizen's children's health plan, immigrant food assistance, a state-only child care subsidy for agricultural workers, and child-only welfare benefits (child-only because the parents are undocumented). At a time when core services for citizens are in jeopardy, these programs need to be closely examined.

F. Reduce mandatory allocations

- **Ease state's future financial liability by eliminating unfunded laws** – For budget reasons, funding tied to the laws created by Initiative 728 and I-732 (2000) has been reduced or suspended more often than not. Similarly, the "paid family leave" (2007) and the "working families tax credit" (2008) laws have never been fully supported in the budget, existing only as statutes with administrative costs attached. While these laws all are well-intentioned, their full costs must be included when projecting the state’s financial liability. The reform would be to clear the mandatory allocations these laws represent from the books, thereby improving the state’s budget outlook for future biennia by more than $1 billion.

Bottom Line

Should a ‘Reform before Revenue’ approach be adopted by the Legislature, so as to ensure that every efficiency, improved effectiveness and savings option is pursued before asking voters to pay more in taxes?

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3. “Separation of Degrees: State-by-State Analysis of Teacher Compensation for Master’s Degrees”, UW Center on Reinventing Public Education (Marquerite Roza and Raegen Miller, July 2009), p. 1. http://www.crpe.org/cs/crpe/download/csr_files/rr_crpe_masters_jul09_db.pdf
4. Id., p. 3.
5. Id., p. 1.
6. http://www.sao.wa.gov/EN/Audits/SGPR/Documents/K-12_Exec_Summary.pdf
7. 2002 Tax Structure Study, Volume 1 (p. 20) and Volume 2 (p. 24).
8. Prosperity Partnership, "Puget Sound Regional Competitiveness Indicators, 2008-2009 Update, p. 44 (http://www.prosperitypartnership.org/indicators/indicators2008-2009.pdf)
9. SB 6645, DOR staff estimate, per voicemail (2/11/09).
10. RCW 41.80.010(6).
11. http://www.senaterepublicans.wa.gov/budgettidbits/2011/031011BudgetTidbit.pdf
12. Joint Legislative Audit and Review Committee, "Performance Audit of the Implementation of Competitive Contracting" (Jan. 2007) ; Washington Policy Center, "How Competitive Contracting can help Balance the Budget without Raising Taxes" (Dec. 2009).
13. OFM Self-Insurance Premium & Defense History (FY 91-11) (FY 91-93: $24 million; FY 09-11: $151 million).
14. Id.
15. 2003 Senate Operating Budget, Highlights, p. 49 (http://leap.leg.wa.gov/leap/Budget/Detail/2003/so0305highlights0402.pdf)
16. Moody’s 2010 State Debt Median Report (May 2011, finding Washington’s per capita debt was $2,626 vs. $1,066 median, ranking Washington 7th highest in country) (http://www.vermonttreasurer.gov/sites/treasurer/files/pdf/bonds/Moody's%20State%20Debt%20Medians%202011-corrected.pdf)
17. SJR 8215 (2011).
18. H.R. 3590 “The Patient Protection and Affordable Care Act”, Sec. 2001 (2010). See also http://www.senaterepublicans.wa.gov/budgettidbits/2010/102510BudgetTidbit.pdf
19. http://ccf.georgetown.edu/index/cms-filesystem-action?file=policy/health reform/national governors association.pdf
20. Ways & Means staff estimate. See also Reset Washington: Home Care Workers http://www.youtube.com/watch?v=06msYtrWtGA
21. Reset Washington: Non-Citizen Services (http://www.youtube.com/watch?v=JNtqf3irhLE) (note: figures no longer include BHP, due to legislative action in 2011)